

**Summary of Testimony of
Commissioner William L. Massey
Federal Energy Regulatory Commission
Before the Subcommittee on Energy and Air Quality
United States House of Representatives**

**Washington, D.C.
May 1, 2001**

Because we are likely to see shortages of electric generating capacity this summer and out of control prices in the region, Congress should enact effective price mitigation across the entire Western Interconnection now to restore just and reasonable prices. Such mitigation must apply at all times, have an end point, and should be based on costs. Under normal circumstances, I would not recommend that market price issues be addressed through legislation because it is the Commission's responsibility to adopt effective price mitigation under the Federal Power Act's just and reasonable standard. But circumstances are dire and the Commission has failed to impose effective price mitigation. Without a time out in electricity markets, I fear for the health of the western economy as high prices ripple through the region.

Most of the provisions of the draft Electricity Emergency Act of 2001 are reasonable. I offer the following comments:

- Congress should transfer transmission siting authority to the Commission or at least establish the FERC as a backstop when state authorities fail to act.
- Section 108 should not be limited to transmission facilities that are acquired by the State of California. Congress should place all interstate transmission under one set of open access rules.
- Section 306 should be broadened to give FERC the express authority to require a single RTO for the West whether or not it is requested by ten governors; and to authorize the Commission to require the formation of RTOs and to shape their configuration in all states.
- The hydro license provisions of section 301 should require a reasonable balancing with environmental concerns.
- Congress should authorize the promulgation of mandatory reliability standards that would be reviewed by the Commission and applied by RTOs.

- Congress should provide the Commission with direct authority to remedy market power in electricity markets.

**TESTIMONY OF
COMMISSIONER WILLIAM L. MASSEY
FEDERAL ENERGY REGULATORY COMMISSION
BEFORE THE SUBCOMMITTEE ON ENERGY AND AIR QUALITY
UNITED STATES HOUSE OF REPRESENTATIVES**

**Washington, D.C.
May 1, 2001**

Mr. Chairman and Members of the Subcommittee on Energy and Air Quality:

Thank you for the opportunity to testify on the proposed Electricity Emergency Act of 2001. I know that Chairman Barton has worked hard to find legislative measures that will help the western states deal with the electricity crisis they are now facing. While I will comment on many of the measures currently in the bill, I must first discuss a very important measure that is not in the bill.

Effective price mitigation

Unless there are dramatic improvements in supply, weather, or demand responsiveness, we are likely to see shortages of electric generating capacity this summer with a continuation, and probably an escalation, of out of control prices in the West. To stem the likely economic dislocation, I believe Congress should enact effective price mitigation for the Western Interconnection now. We need a time out in this dysfunctional electricity market.

Under normal circumstances, I would not recommend that market price issues be addressed through legislation. I believe that it is the Commission's responsibility to adopt effective price mitigation when necessary. The Commission has ample

authority to do so under the Federal Power Act's just and reasonable standard, and acting under that standard is the more appropriate course. But circumstances are dire as the West faces the second summer of an electricity emergency and the Commission has failed to impose effective price mitigation. The Commission's recent order, on which I dissented, imposes price mitigation only when reserves drop below 7%. Yet there is evidence that sellers exercise market power in all hours to drive up prices. Thus, with summer fast approaching, I have no choice but to recommend that Congress act. Without more forceful and comprehensive price mitigation, I fear for the health of the western economy as high prices ripple through the region over the next few months.

Ideally, effective price mitigation must apply to the entire Western Interconnection, during all hours, must have an end point, and should be based on costs. In my prior testimony, I described a generator specific cap that would be based on variable costs plus a reasonable profit. There may be other ways to craft effective price mitigation that will restore just and reasonable prices in the Western Interconnection. I would recommend immediate Congressional action in this area.

Demand responsiveness

Section 101 (Demand Management Agreements Clearinghouse) and section 102 (Price Mitigation in Western Market through Demand Management Incentives) provide measures that will help improve demand responsiveness in electricity markets. Demand responsiveness is a critical feature that is largely absent from

electricity markets. Without the ability of customers to respond to price, there is virtually no limit on the price that suppliers can fetch in shortage conditions. Consumers see the exorbitant bill only after the fact. This does not make for a well functioning market.

The demand responsiveness provisions of the bill move in the right direction and I support them. I support the market based approaches in the bill and observe that the Commission may be able to use the private sector for organizing a clearinghouse for agreements, subject to Commission oversight. I would recommend, however, that the Commission be allowed to make a recommendation to extend the provisions of section 102 beyond the proposed October 1, 2002 termination date, as is allowed for in section 101.

Transmission issues

Section 103 (Transmission Constraints Study), section 104 (Path 15 Transmission Expansion), section 105 (Tribal Energy Office), section 106 (Federal Transmission Corridors), and section 108 (Sale of Transmission Assets to the State of California) of the bill address important transmission issues. Identifying transmission constraints and developing a plan for relieving them, identifying transmission corridors across Federal land, and finally relieving the long standing constraint on California's notorious Path 15 are all positive developments and I support them. I must observe, however, that those provisions are unlikely to have much impact on the market over the next several months.

I would add two observations. First, constraints should be relieved in the least cost manner. Constraints may be relieved by adding generation, adding transmission, or increasing demand responsiveness. I recommend that Congress require that constraints be relieved in the least cost manner.

And second, I strongly believe that the major impediment to the addition of new transmission facilities is the inability to site them. To address this problem, I recommend empowering the Commission to site new transmission facilities. The transmission grid is the critical superhighway for electricity commerce, but it is becoming congested due to the increased demands of a strong economy and to new uses for which it was not designed. Transmission expansion has not kept pace with these changes in the interstate electricity marketplace. The Commission has no authority to site electric transmission facilities that are necessary for interstate commerce. Existing law leaves siting to state authorities. This contrasts sharply with section 7 of the Natural Gas Act, which authorizes the Commission to site and grant eminent domain for the construction of interstate gas pipeline facilities. Exercising that authority, the Commission balances local concerns with the need for new pipeline capacity to support evolving markets. We have certificated 10,000 miles of new pipeline capacity over the last six years. No comparable expansion of the electric grid has occurred.

I recommend legislation that would transfer siting authority to the Commission or at least establish the FERC as a backstop when state authorities fail to decide on

proposed expansions within a specified period of time. Such authority would make it more likely that transmission facilities necessary to reliably support emerging regional interstate markets would be sited and constructed. A strong argument can be made that the certification of facilities necessary for interstate commerce to thrive should be carried out by a federal agency.

Section 108 of the bill would subject to FERC jurisdiction any transmission facilities that are acquired by the State of California. I support the principle underlying this recommendation but see no reason to limit its application to California only. Congress should place all interstate transmission under one set of open access rules. That means subjecting the transmission facilities of all municipal electric agencies and rural cooperatives, the Tennessee Valley Authority, and the Power Marketing Administrations to the Commission's open access rules.

In addition, all transmission, whether it underlies an unbundled wholesale, unbundled retail, or bundled retail transaction, should be subject to one set of fair and non-discriminatory interstate rules administered by the Commission. This will give market participants confidence in the integrity and fairness of the interstate delivery system, and will facilitate robust trade by eliminating the current balkanized state by state rules on what is essentially an interstate delivery system.

Western-wide RTO

Section 306 of the bill would require all entities in the WSCC to participate in a single RTO if at least ten of the fourteen governors within the WSCC agree. I

would interpret this provision as a strong Congressional endorsement of a Western Interconnection RTO. I wholeheartedly agree with that goal. The Western Interconnection functions as a single market. I firmly believe that large RTOs consistent with FERC's vision in Order No. 2000 are absolutely essential for the smooth functioning of electricity markets. RTOs will eliminate the conflicting incentives vertically integrated firms still have in providing access. RTOs will streamline interconnection standards and help get new generation into the market. A single RTO for the West will help ensure access to the western power market, improve transmission pricing, regional planning, congestion management, and produce consistent market rules across the West. We know for a fact that resources will trade into the market that is most favorable to them. Trade should be based on true economics, not the idiosyncracies of differing market rules across the region.

To realize these many potential benefits, RTOs must be truly regional in scope - - large and well shaped. Markets are regional in scope - - this has been well demonstrated recently as prices over the entire West rose and fell with events in California. Thus, we need an RTO that covers the entire West.

I would add two caveats to my support for this provision. First, the FERC should have the express authority to require a single RTO for the West whether or not it is requested by ten governors. Establishing the needed institutions for just and reasonable terms and conditions for interstate wholesale markets is a federal responsibility.

And second, I recommend that the Congress clarify existing law to authorize the Commission to require the formation of RTOs and to shape their configuration in all states, not just those in the West. I continue to believe strongly that the development of well structured Regional Transmission Organizations is a necessary platform on which to build efficient electricity markets. The full benefits of RTOs to the marketplace will not be realized, however, if they do not form in a timely manner, if they are not truly independent of merchant interests, or if they are not shaped to capture market efficiencies and reliability benefits.

Emergency power sales

Section 107 prohibits orders requiring emergency sales of electricity or natural gas unless payment is guaranteed. This is a reasonable provision and I support it. I agree that sellers should be paid for their product. But I must emphasize the obvious: payment should be for prices that are just and reasonable.

PURPA contracts

Section 205 of the bill provides for the ability of a PURPA QF to sell its output to a third party if the utility purchaser is unable to meet the payment terms of the power purchase agreement. This is a reasonable provision and I support it.

Federal assistance available during electric emergencies

Although section 201 (Emergency Conservation Awareness), section 202 (Preparation for Electricity Blackouts), section 203 (Conservation at Federal Facilities), and section 204 (Daylight Savings Time) of the bill do not appear to

directly implicate FERC authority, they appear to be reasonable proposals that I would endorse.

Hydroelectric power license conditions

Section 301 would require the Commission to promulgate a standard license article, applicable and available to all FERC licensed facilities. The article would permit any licensee to suspend, for up to two years, any or all of its minimum flow requirements. The licensee's authority to invoke the article would be triggered by an emergency declaration by the Governor of the State in which the licensee's facilities are located.

I am concerned with the breadth of this provision. Although the section does provide for a consultation period, in which relevant resource agencies could express their concerns, the licensee could suspend any minimum flow regimes previously required by the Commission. Many of these minimum flow provisions are critical tools in balancing power generation and resource protection.

The Federal Power Act provides that the responsibility for determining the proper balance between the development of hydro power and environmental protection rests with FERC. The Commission recently encouraged Commission licensees in the West to examine their projects for the purpose of identifying any efficiency modifications that could result in increased generation, while identifying any environmental impacts that could occur. This approach will allow FERC to

expedite consideration and approval of proposals to increase generation in emergency situations, while respecting environmental considerations.

Additional Recommendations

I made recommendations for Federal legislation in some of the earlier sections of this testimony. The following additional recommendations for legislation will ensure that the nation reaps the benefits of well-functioning electricity markets.

We need mandatory reliability standards. Vibrant markets must be based upon a reliable trading platform. Yet, under existing law there are no legally enforceable reliability standards. The North American Electric Reliability Council (NERC) does an excellent job preserving reliability, but compliance with its rules is voluntary. A voluntary system is likely to break down in a competitive electricity industry.

I strongly recommend federal legislation that would lead to the promulgation of mandatory reliability standards. A private standards organization (perhaps a restructured NERC) with an independent board of directors would promulgate mandatory reliability standards applicable to all market participants. These rules would be reviewed by the Commission to ensure that they are not unduly discriminatory. The mandatory rules would then be applied by RTOs, the entities that will be responsible for maintaining short-term reliability in the marketplace. Mandatory reliability rules are critical to evolving competitive markets, and I urge Congress to enact legislation to accomplish this objective.

And second, I recommend legislation that would give the Commission the direct authority to mitigate market power in electricity markets. It should be clear by now that, despite our efforts, market power still exists in the electricity industry. The FERC, with its broad interstate view, must have adequate authority to ensure that market power does not squelch the very competition we are attempting to facilitate. However, the Commission now has only indirect conditioning authority to remedy market power. This is clearly inadequate. Therefore, I recommend legislation that would give the Commission the direct authority to remedy market power in wholesale markets, and also to do so in retail markets if asked by a state commission that lacks adequate authority.

Conclusion

I stand ready to assist the Subcommittee in any way, and I thank you for this opportunity to testify.